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SUBJECT: BRAZIL'S EXPANDING TRADE WITH CHINA

REF: BRASILIA 3461

1. (U) Summary. The Lula administration has embarked on a determined policy of export expansion in China, seeking to build on the boom in this bilateral trade relationship that began in 2000. The Chinese appear to welcome the approach, sending at least five trade delegations to Brazil this year and demonstrating their confidence with increased investment. Brazil's surplus with China has led the latter to seek relatively minor reciprocal market opening. Brazilian diplomats and trade officials forecast continued growth in trade with China over the long term, rejecting speculation that the current boom will be short-lived as Chinese production capacity catches up with demand for several key products like steel. The Brazilian desire to strengthen ties with China in the wake of the WTO Ministerial in Cancun and the formation of the G-20( /-) developing country alliance contributed to the increase in official visits, and may lead to a Lula visit to China next year. There has been speculation that China will officially join India, Brazil and South Africa to form an expanded G-3. While strong partnerships exist in several areas, trade is the leading current attraction in the Sino-Brazilian relationship. End Summary.

#### The Statistics

2. (U) Brazilian press and the Ministry of Development, Industry and Foreign Trade have touted the fact that, excluding the European Union (Brazilian trade stats list European countries individually), China ranks this year as Brazil's second largest export market, after the U.S. China has advanced from Brazil's 12th largest export market to its second largest since 2000, and now takes in 6.5 percent of Brazil's exports. Over the last year, Brazilian exports to China more than doubled while imports grew by 7.5 percent. Brazil has exported more than \$3.9 billion in goods to China so far this year compared to \$2.1 billion during the same period last year. In comparison, Argentina and Holland (third and fourth in export markets) each purchased approximately \$3.6 billion in Brazilian goods so far in 2003. Soy and iron ore account for approximately seventy-five percent of exports to China, with soy exports almost doubling within the last year. The top ten list includes laminated or semi-manufactured iron and steel, wood products, auto parts and motors, soy oil, and animal furs and skins. Statistics provided by the Chinese Embassy indicate that Brazil is China's tenth largest trading partner, accounting for 1.5 percent of Chinese trade. While far behind the value of the U.S. market to Brazilian exports (\$13.9 billion so far this year), not to mention the EU (\$15 billion so far this year), the Chinese market now merits, and is receiving, increased attention from the Lula administration.

#### The Visits

3. (U) The recent flurry of official visits and deliverables with trade objectives underscore the importance with which the GoB views this relationship. Minister of Development Industry and Foreign Trade Luis Furlan visited Macao in October to take part in the first Forum for Economic and Trade Cooperation between China and Lusophone countries. Minister of Agriculture Rodrigues followed suit in November accompanied by a delegation of Brazilian business leaders. Minister of Defense Viegas also made an official visit to China in November. The number of Chinese delegations visiting Brazil, especially study missions, has overwhelmed the small Foreign Ministry staff dedicated to Asia and Oceania, according to one diplomat. Recent high-level Chinese visitors that have made stops in Brazil as part of regional visits include Chinese Vice-Minister of Agriculture, Fan Xiaojian, who held talks in Brazil in late November, and senior Chinese Communist Party official, Zhang Dejiang, along with a trade delegation from Guangdong province. Lower level trade and investment missions have participated in trade fairs and investigated individual sectors. The Chinese government has also sent a study mission to research Brazil's

social security system. The strengthening of ties between the two countries is also evident in an expanding partnership in technology development (see refTel) and space activities.

14. (U) Press reports of the trips rarely fail to mention the signing of cooperative agreements and the closing of trade deals, the significance of which is often difficult to determine. During Rodrigues' visit in early November the two countries signed a phyto-sanitary protocol and agreed to reciprocal technical exchanges to iron out difficulties in certifying sanitary suitability of a range of agricultural products including citrus, chicken, pork, and beef. Fan Xiaojian's visit produced an accord establishing rules for agricultural marketing and technology transfer, as well as an MOU on cooperation in areas ranging from agricultural biotechnology to food processing and environmental protection. The trade delegation from Guangdong province reportedly closed trade deals in Brazil worth \$150 million.

15. (SBU) At the Forum for Economic and Trade Cooperation in Macao, China and eight Portuguese speaking countries signed on to an action plan covering joint efforts at trade promotion and eliminating trade barriers, exchange of trade and investment information, and cooperation in farming and fisheries. Oswaldo Biato, head of the Ministry of Foreign Relations' office that covers China told Econoff that he believes the motivation behind this forum was not closer trade ties, but Chinese central government support for Macao, which would be the headquarters for the organization which may eventually be founded. Macao's economy, he said, is dependent on tourism and casinos and needed a special niche that was not subject to such variability.

#### The Potential -----

16. (SBU) Despite the dubious trade significance of some of the recent accords signed between China and Brazil, there is little doubt that the GoB sees enormous potential beyond the short term. Biato expects trade to reach \$10 billion by 2006. China, the world's leader in attracting foreign direct investment (\$50 billion in 2003), one of the fastest-growing economies in the world (7% in 2003), and in the second year of its 5-year transition toward full WTO compliance, is looking for strategic, long-term partners, according to Biato. He maintains that even as China's production capacity expands for some key imports like soy and steel, the trade relationship will continue to be robust, especially to meet the needs of a growing middle class. The pairing is natural, as both are developing economic powerhouses in their regions, China has excess capital to invest, and Brazil is cash-starved. The Chinese already have small investments in the Manaus free-trade zone, including a furniture factory and a factory that manufactures televisions. The Chinese are now starting to invest in Brazilian transport projects, including port and railway upgrades, investments that are driven by existing trade in primary products like soy and iron ore. The recent Chinese investment missions focused on electronics, pharmaceuticals, steel production facilities, thermal electric plants, even fire cracker factories.

17. (U) The Chinese market is only just beginning to be exploited by the Brazilian private sector, according to Brazilian officials. Trade with China is concentrated among 40-50 Brazilian firms, many of them multi-nationals. Embraer's joint venture with Harbin Aircraft Industry Group and Hafei Aviation, and Vale do Rio Doce's joint venture exploration company formed with China's Baogang are but two of the better known examples of successful bilateral projects based on the private sector's positive growth calculation of bilateral trade. Export promotion officials have criss-crossed the country encouraging small and medium sized firms to follow the lead of their larger brethren. The GoB, looking to expand exports of manufactured goods to China, has contracted a Chinese consulting firm to research the 15 sectors where Brazil has the best prospects for growth in exports to Asia. Minister Furlan's trade mission included business representatives from sectors with increasing exports to China, including the suppliers of medical equipment, aluminum, shoes, meats, and home appliances.

#### Ag Trade -----

18. (SBU) As China's population continues to grow wealthier, Brazilians see potential for increasing the quantity and variety of agricultural exports, including soy, meat, chicken, pork, fruit, fruit juice, and coffee. Brazil's Commodities and Futures Market exchange soon plans to open an office in Shanghai. Press reports following Agriculture Minister Rodrigues' visit announced that China had certified Brazilian beef for import, predicting certification for poultry exports soon. (Note: Hong Kong is the third largest market for Brazilian pork and second largest for chicken parts.) Officials on both sides have overcome earlier difficulties with soy shipments regarding identification of

genetically modified product and the existence of a weed that Chinese officials believed to be harmful. Biato told econoff that the Chinese phyto-sanitary problems with Brazilian soy mask other concerns regarding food security and over-dependence on food imports. The Chinese government is trying to encourage its farmers to grow soy, but is meeting resistance, he said.

9. (SBU) Biato acknowledged that there was some truth to press accounts of Chinese officials demanding reciprocity to address China's unfavorable trade balance with Brazil. These reports appeared in Brazilian media during Rodrigues' visit, at about the same time as articles claiming that the U.S. was pressuring China and Russia to buy more chicken and soy in an attempt to reduce Brazilian sales. Biato said that Chinese officials did press for market opening for garlic, corn, tripe, apples, lychee and longan fruit. More significantly, he noted, China has requested that Brazil apply market economy status to China, thereby limiting the potential for dumping cases. (Note: Brazil currently has a safeguard in effect to protect its toy industry from the onslaught of mostly Chinese produced competitors.) Brazil is considering this, as well as a quota for Chinese garlic. Biato underscored the mainly symbolic nature of this reciprocity, saying a \$2 billion trade deficit with Brazil is insignificant for the Chinese.

Political bonds

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10. (SBU) Despite rumblings that China would soon join the India-Brazil-South Africa Dialogue Forum (IBSA), sometimes called the G-3, Biato denied this, saying that IBSA was still in its infancy and needed to focus on concrete bi- and tri-lateral projects making use of the geographical realities that join the three before branching out. Biato did not speculate about potential difficulties with India should its regional rival express a desire to join IBSA. However, Brazil strongly encourages China's support for a development agenda in other multilateral fora, like the WTO. According to press reports, China supports Brazil's bid for a permanent seat on the UN Security Council. Chinese participation in the upcoming G-20 meeting in Brazil is expected, and Biato confirmed the realistic possibility of a Lula trip to China sometime next year. The relationship encompasses many areas of cooperation, he said, but trade will be a growing area of interest for Brazil.

11. (SBU) Comment: The GoB reserves a special place for China in its export promotion efforts, and likewise counts China as a partner in advancing its global trade agenda. While the money to be made in strong trade links to China is not lost on the Brazilians, they also are aware of potential pitfalls in opening their own market to the export machine that is China, as the toy safeguard demonstrates. Likewise, Brazilian companies know that doing business with and in a not-quite-yet market economy has its downside. Lax intellectual property rights protection in China is one example of a negative factor for Brazil. Contraband in pirated goods, much of it originating from China, helps to fuel organized crime in Brazil and frustrates the efforts of the GoB to improve its IPR enforcement. A September "Estado de Sao Paulo" article noted the case of Embraco, a Brazilian company making compressors that launched a joint venture in China to produce for the local market in 1995. The company's operations director cited lack of patent protection for the company's switch from local to foreign suppliers, as their competitors could easily buy copies of their designs from the local suppliers. In the quest for export markets and building stronger south-south linkages, Brazil appears willing to give its developing partners a break on points of trade liberalization that do not seriously jeopardize the relationship. While the trade stats continue to point to an enriching relationship for Brazil, any bilateral irritants are likely to be downplayed.

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